

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
LORENZO AND GIULIA MARTINELLI,)
SERAFINO J. AND CARMEL MARTINELLI,)
AND JOHN H. AND LAURA M. ADAMS)

Appearances:

For Appellants: Joseph A. Lukes
Attorney at Law

For Respondent: Lawrence C. Counts
Tax Counsel

O - P I N I O N

These appeals are made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Lorenzo and Giulia Martinelli, Serafino J. and Carmel Martinelli, and John H. and Laura M. Adams against proposed assessments of additional personal income tax' against Lorenzo and Giulia Martinelli in the amounts of \$309.71, \$159.12, and \$97.43 for the years 1961, 1962, and 1963, respectively; against Serafino J. and Carmel Martinelli in the amounts of \$154.86, \$79.56, and \$48.72 for the years 1961, 1962, and 1963, respectively; and against John H. and Laura M. Adams in the amounts of \$17.81, \$45.47, and \$126.03 for the years 1961, 1962, and 1963, respectively,

Appellants own partnership interests in Martinelli Enterprises which is engaged in the motel and apartment business, This partnership owns a large complex consisting of 98 motel and apartment units.' In recent years apartment rentals have been the primary business, Pets and children are allowed,

Martinelli Enterprises had expanded in 1960 by constructing a new 12-unit apartment building. At the same time 14 existing motel units were improved by converting garage spaces into kitchens. The total cost of this construction and improvement was \$107,891.00. The accountant for the partnership testified that approximately \$65,000.00 of this amount was spent for the new apartment building. Also in 1960 Martinelli Enterprises spent \$31,580.78 for furniture and equipment, some of which was used to furnish the new apartments and motel kitchens, and the balance to furnish other motel improvements not at issue here. The partnership used the double declining balance method of depreciation, and assigned 25-year useful lives to the apartment building and motel improvements, and a 6-year life to the furniture and equipment. The Franchise Tax Board has extended these useful lives -to 40 years for the realty and 8 years for the furniture and equipment. Whether appellants were warranted in using the shorter useful lives is the primary issue presented in the instant case.

The second issue is whether appellants should be allowed a depreciation deduction for a used Chrysler automobile purchased in 1959 for the use of Giulia Martinelli, the managing partner of the business. The Franchise Tax Board has disallowed all depreciation of this vehicle.

At the hearing of this matter, Mrs. J. E. MacNeill, the partnership accountant, testified that a 25-year life was chosen for the **realty** because the construction was of minimum quality. She also testified that the cost to furnish and equip an improved motel unit was approximately \$500, and somewhere between \$600 and \$750 for an apartment. For the period 1961 through 1966 \$52,032.08 was spent to replace furniture and equipment for all 98 units owned by the partnership. Mrs. MacNeill stated that an agent of the Internal Revenue Service inspected the partnership property, and subsequently the Service accepted the useful lives chosen by appellants. The accountant testified that the Chrysler automobile was used by Mrs. Martinelli solely for partnership business, such as purchasing and transporting supplies. No other vehicle was owned by Martinelli Enterprises. For personal transportation, Mrs. Martinelli used her husband's automobile,

Mr. Maurice Rosano, an experienced apartment builder and owner, testified that the apartment building and motel improvements were very cheaply constructed. In trade terminology they would be referred to as "ding bats;" that is, something just thrown together. His inspection of the apartment building revealed that the windows, screens, and window sealing were in a state of disrepair; telephone wires were exposed; water heaters were located outside in lean-to's; and the roof would only last about another four years.

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Referring to the motel improvements, the contractor testified that the plumbing for the new kitchens was exposed; the pipes from the units were lying on top of the ground; and that the roof needed immediate attention. He concluded that a 25-year life for these apartment and motel improvements was appropriate,

Records were introduced to show that for the three-year period 1961 through 1963 \$12,294.40 was spent for maintenance of the 98 units.

Section 17208 of the Revenue and Taxation Code allows as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in a trade or business or held for the production of income. This deduction is based in part upon the estimated useful life of the property. Regulation 17208(a), subdivision (2), title 18, California Administrative Code, defines useful life as follows:

. . . the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factors to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions, and current developments within the industry and the taxpayer's trade or business, and (4) the taxpayer's policy as to repairs, renewals, and replacements... If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination.

The Franchise Tax Board based its extension of the useful lives of the apartment building, motel improvements, and furniture and equipment upon personal inspections and upon federal guidelines. (See Rev. Proc. 62-21, 1962-2 Cum.Bull.418.) Appellants now have, the burden of-showing

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that these federal averages- are inaccurate in, the instant situation, and that the useful lives chosen by appellants are reasonable, (Appeal of Continental Lodge, Cal, St, Bd. of Equal,, May 10, 1967.) We think that they have successfully carried this burden,

Appellants introduced substantial evidence to show that the apartments and motel improvements were constructed as cheaply as possible, Already these structures are showing material signs of disrepair. Only approximately \$40 per unit was spent for maintenance each year, Both the apartment and the motel units are primarily rented to permanent tenants, and therefore receive more intensive **use**, In addition, pets and children are allowed.

Over the six-year period 1961 through 1966 Nartinelli Enterprises spent \$52,032.08 to' replace furniture and equipment for all 98 units. The partnership accountant testified that the cost of presently furnishing and equipping an apartment is between \$600 and \$750, and the cost for a motel improvement is approximately \$500. Using an approximate average of \$600 per unit, the cost of 'presently furnishing 98 **units** is \$58,800, Taking into account a certain increase for inflation, this figure is close to the amount spent by the partnership for replacement over **the** six years 1961 through 1966, Therefore, the partnership is getting about a six-year life from this property,

We conclude that appellants have adequately shown that 25-year useful lives for the apartment building and motel improvements, and a 6-year life for the furniture and equipment, were accurate.

The Franchise Tax Board has challenged the depreciation deduction for the partnership automobile, We think that appellant has established that this vehicle was needed for proper management of the complex, and that it was used only for that purpose. The depreciation deduction should be allowed.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Lorenzo and Giulia Martinelli, Serafino J. and Carmel Martinelli, and John H. and Laura M. Adams against proposed assessments of additional personal income tax against Lorenzo and Giulia Martinelli in the amounts of \$309.71, \$159.12, and \$97.43 for the years 1961, 1962, and 1963, respectively; against Serafino J. and Carmel Martinelli in the amounts of \$154.86, \$79.56, and \$48.72 for the years 1961, 1962, and 1963, respectively; and against John H. and Laura M. Adams in the amounts of \$17.81, \$45.47, and \$126.03 for the years 1961, 1962, and 1963, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 5th day of February , 1968, by the State Board of Equalization,

_____, Chairman

Paul R. Leake, Member

John W. Lynch, Member

Go R. Leake, Member

_____, Member

ATTEST:

W. Freeman, Secretary